

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
GARDEN WAY INCORPORATED	:	DETERMINATION
for Revision of Determinations or for Refund	:	DTA NOS. 809048
of Sales and Use Taxes under Articles 28 and 29	:	AND 809714
of the Tax Law for the Period March 1, 1984	:	
through August 31, 1989.	:	

Petitioner, Garden Way Incorporated, 102nd Street and 9th Avenue, Troy, New York 12180, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1984 through August 31, 1989.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on July 31, 1992 at 9:15 A.M. Petitioner filed a brief on September 18, 1992. The Division of Taxation filed a brief on November 13, 1992. Petitioner filed a reply brief on December 3, 1992. Petitioner appeared by Thomas E. Roche, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Carroll R. Jenkins, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly assessed sales tax on the full cost of petitioner's purchase of envelopes which had promotional copy and graphic depictions printed thereon, where such envelopes were mailed free of charge to petitioner's customers outside the State of New York, as part of petitioner's marketing program, or whether such envelopes were exempt from tax pursuant to Tax Law § 1119(a)(2) or, alternatively, (4).

FINDINGS OF FACT

The instant matter involves two audits of petitioner, Garden Way Incorporated. The first audit resulted in the issuance of a Notice of Determination and Demand for Payment of Sales and Use Taxes Due dated December 20, 1989 which assessed \$136,892.46 in additional tax

due, plus interest, for the period March 1, 1984 through February 28, 1987. The second audit resulted in the issuance of a similar statutory notice dated April 8, 1991 which assessed additional tax due of \$161,660.96, plus interest, for the period March 1, 1987 through August 31, 1989.

The assessments herein result from the Division of Taxation's ("Division") determination on audit that petitioner improperly failed to pay sales or use taxes on its purchase of certain envelopes (more fully described hereinafter).

Stipulated Facts¹

Petitioner is engaged, in the State of New York, in the business of manufacturing and selling outdoor power equipment. Petitioner's base of operations is in Troy, New York. A substantial portion of petitioner's products are marketed by way of direct mail solicitations to customers and potential customers in New York and throughout the United States.

Petitioner is a registered vendor for purposes of Articles 28 and 29 of the Tax Law.

Petitioner markets its products through regular, periodic promotional campaigns wherein envelopes and their promotional contents (hereinafter the envelopes and promotional contents are referred to as "promotional packets") are sent from petitioner's place of business in New York to customers and potential customers within and without the State.

The items at issue in this case are the envelopes which are a part of the promotional packets. The envelopes at issue have advertising copy and promotional depictions printed thereon, and are referred to hereinafter as the "promotional envelopes."

Precision Marketing Associates, a division of Garden Way Incorporated, designs the promotional envelopes, the advertising copy, graphic depictions and the promotional inserts that go into the promotional envelopes. Design and copy for the promotional envelopes are then

¹At hearing, the parties submitted into evidence a Stipulation of Facts, dated July 31, 1992. Said stipulation is reproduced here in its entirety as Findings of Fact "3" through "25" with minor editing for clarification and consolidation.

sent to West Shore Envelope Company ("West Shore") to do the printing and folding of the promotional envelopes. During the printing process, West Shore also prints the bulk rate permit indicia required by the U.S. Postal Service contract on each envelope that will be mailed at bulk rate.

West Shore purchases the paper and other required materials, does the printing and folding and returns the printed promotional envelopes to petitioner in Troy.

Introduced into the record herein (as Exhibit "F") were copies of postal regulations and contracts between petitioner and the U.S. Postal Service which accurately reflected the agreements that existed between petitioner and the U.S. Postal Service during the audit periods.

Promotional packets to be mailed by bulk rate to addressees in Canada are shipped via common carrier from petitioner's place of business to a bulk rate facility located in Canada. The procedures for sorting and delivery of bulk rate Canadian mail are essentially the same as those for U.S. mail. The U.S. Postal Service does not, however, have any involvement with the processing or delivery of petitioner's bulk rate mailings to Canadian addressees.

At petitioner's Troy location, advertising and promotional materials are inserted into the promotional envelopes and the promotional envelopes are addressed. [Generally, addresses are printed on the promotional materials which are inserted into the envelopes. These addresses are visible through a window in the promotional envelope.] The promotional packets are sorted by petitioner according to their destination pursuant to petitioner's contract with the U.S. Postal Service.

At petitioner's Troy location, the addressed promotional packets are then placed into bags provided by the U.S. Postal Service. Each bag has a destination tag affixed to the bag by petitioner's employees. An employee of the U.S. Postal Service inspects random samples of the bags to verify their contents. A truck or conveyance owned or contracted for by the U.S. Postal Service comes to petitioner's place of business, the bags are loaded onto the trucks, and the truck is then sealed. Bags containing promotional packets which are to be mailed by bulk rate are delivered to the U.S. Postal Service's Bulk Rate Facility in Springfield, Massachusetts. The

trucks containing petitioner's bulk rate mail bags will, if fully loaded, travel directly to Springfield or, if not fully loaded, may stop at the Albany Postal Service facility and pick up additional bulk rate mail bags destined for Springfield. Bags containing promotional packets that are to be sent by first-class mail are delivered to the U.S. Postal Service Facility in Troy, New York.

The unopened bulk rate bags are distributed from the Bulk Rate Facility in Springfield, Massachusetts to various local post office facilities across the country. The bags are opened at their local destination where the promotional packets are delivered to their respective addressees.

Set forth below are 10 categories representing the 10 different types of items that are at issue in this case. The parties agree that each of the promotional envelopes can be classified as fitting into one of the 10 different categories. The parties also agree that the samples introduced at the hearing illustrate the general type of item represented in each of the 10 separate categories.

Categories of Promotional Envelopes at Issue²

9 x 12 Envelopes

1. Full color photographic depictions with advertising copy.
2. Black and white photographic depictions with advertising copy.
3. Advertising copy only.

6 x 9 Envelopes

4. Full color photographic depictions with advertising copy.
5. Black and white photographic depictions with advertising copy.
6. Advertising copy only.

#9 and #10 Envelopes

7. Advertising copy only.

²This list is a reproduction of Stipulation Exhibit "1" which was expressly made part of the stipulation.

8. Black and white photographic depictions with advertising copy.

9. Full color photograph depictions with advertising copy.

10. No advertising copy.

Petitioner organized and numbered invoices from West Shore reflecting the full purchase price paid by petitioner for each shipment of promotional envelopes. The invoices have been labeled with consecutive reference numbers and then classified as being in one of the 10 categories referred to.

Submitted into evidence and attached to the stipulation of facts was a document prepared by petitioner which represents the agreed upon classification of each West Shore invoice. The promotional envelopes that correspond to each invoice are therefore classified in this document (referred to herein as Stipulation Exhibit "2") as being in one of the 10 different categories.

Stipulation Exhibit "2" also sets forth the amount of tax due (not including interest) if the full purchase price reflected on each invoice was subject to taxation as contended by the Division. The parties agree that the tax due as calculated by the Division and set forth in Stipulation Exhibit "2" is the correct calculation of tax due if the full purchase price reflected on each invoice is subject to taxation.

The parties agree that the full purchase price of the promotional envelopes classified under category No. 10 (no advertising copy) is subject to taxation. The total amount of tax attributable to this category for both audit periods is \$6,576.05.

The parties also agree that the promotional envelopes in the remaining categories (categories 1-9) have promotional and/or advertising material printed thereon. The tax asserted on the full cost of these promotional envelopes, when mailed to addressees outside New York, is the only tax in dispute in this proceeding.

The parties agree that the full purchase price of all envelopes mailed to New York addressees, whether containing promotional material or not, are taxable and the tax due on such

items is not in dispute. The amount of tax attributable to this category for both audit periods is \$12,828.20.

Also attached to the stipulation of facts is a table that accurately summarizes the invoice-by-invoice breakdown that is contained in Stipulation Exhibit "2". The parties agree that this table, referred to herein as Stipulation Exhibit "3", accurately sets forth the total tax due on each category of envelope, if as the Division contends, the full purchase price is subject to taxation.

Stipulation Exhibit "3" also summarizes the tax due by category of promotional envelope for the earlier audit period as calculated by use of statistical projections rather than by examining individual invoices. The parties agree that Stipulation Exhibit "3" sets forth the total tax due by category for the first audit period if, as the Division contends, the full purchase price of each promotional envelope is subject to taxation.

Due to the utilization of samples and projections during the first audit period and the fact that some West Shore invoices from the second audit period have been lost or destroyed in the course of business, the parties have agreed to use statistical projections for purposes of classifying invoices that were not included, for the second audit period, in Stipulation Exhibit "2". Stipulation Exhibit "3" also summarizes the projected tax due by category of promotional envelopes for second audit period invoices that have been lost or destroyed. Specifically, Stipulation Exhibit "3" indicates the following total tax due by category of promotional envelope:

<u>Category</u>	<u>Total Tax Due</u>
9 x <u>12</u>	
1	\$ 50,743.84
2	38,153.72
3	21,176.72
6 x <u>9</u>	
4	\$ 16,239.12
5	11,638.78
6	3,433.39
#9 & #10	
7	\$ 48,076.13

8	40,056.06
9	49,796.95
10	<u>6,512.93</u>
Total	\$285,827.64

Also submitted with the stipulation of facts is a table, identified herein as Stipulation Exhibit "4", showing the tax due on promotional envelopes that were processed through the U.S. Postal Service Bulk Rate Facility in Springfield, Massachusetts, the tax due on promotional envelopes that were sent via first class mail through Troy, New York, as described, supra, and the tax due on promotional envelopes that were sent via bulk rate to Canadian addresses. The parties agree that Stipulation Exhibit "4" reflects the amount of tax due if, as the Division contends, the full purchase price of these promotional envelopes is subject to taxation.

The parties agree that the promotional materials that are inserted into the promotional envelopes are not subject to taxation when the resulting promotional packets are sent to out-of-state recipients. The parties agree that the full purchase price of the entire promotional packet is subject to taxation when the packet is sent to New York addresses.

Additional Facts

Approximately 90% of the cost of the promotional envelopes remaining at issue herein (that is, categories 1-9) is attributable to the advertising printed thereon. This 90% figure does not include development costs associated with the promotional envelopes. Such costs are significant, as petitioner continuously tests its promotional envelopes in order to gauge their effectiveness in promoting sales. Based on such testing, petitioner determines which promotional envelopes "work" and which do not. Envelopes that do not work are improved or are discontinued. The promotional envelopes at issue are thus part of petitioner's sophisticated direct marketing strategy, which features several different packages of promotional materials and promotional envelopes to generate sales. Approximately 60% of petitioner's sales during the period at issue were sold via direct marketing directly to customers. Also during this period, about 25% of petitioner's sales were made through dealers. Of this 25%, about one-half were generated by petitioner's direct mail efforts.

CONCLUSIONS OF LAW

A. At the outset, it should be noted that petitioner's purchases of the promotional envelopes constituted a purchase of tangible personal property in New York and were therefore properly subject to sales or use tax absent a specific statutory exemption (Tax Law §§ 1105[a], 1110]). Petitioner thus bore the burden of proving that its purchases of promotional envelopes were exempt from tax (Tax Law § 1132[c]; 20 NYCRR 3000.10[d][4]).

B. Petitioner asserted that its purchases of promotional envelopes were exempt from tax pursuant to Tax Law § 1119(a)(2) or, alternatively (4), which provides as follows:³

"Subject to the conditions and limitations provided for herein, a refund or credit shall be allowed for a tax paid pursuant to subdivision (a) of section eleven hundred five or section eleven hundred ten . . . , (2) on the sale or use of tangible personal property purchased in bulk, or any portion thereof, which is stored and not used by the purchaser or user within this state if that property is subsequently reshipped by such purchaser or user to a point outside this state for use outside this state . . . , (4) on the sale or use within this state of tangible personal property, not purchased for resale, if the use of such property in this state is restricted to fabricating such property (including incorporating it into or assembling it with other tangible personal property), processing, printing or imprinting such property and such property is then shipped to a point outside this state for use outside this state"

C. During the period at issue, Tax Law § 1101(b)(7) defined "use" as follows:

"Use. The exercise of any right or power over tangible personal property by the purchaser thereof and includes, but is not limited to, the receiving, storage or any keeping or retention for any length of time, withdrawal from storage, any installation, any affixation to real or personal property, or any consumption of such property."

D. Petitioner's receipt and storage of the promotional envelopes clearly constituted a "use" of such envelopes within the meaning of Tax Law

³It is noted that Tax Law § 1119, which provides for a credit or refund of sales or use taxes under certain circumstances, is not, strictly speaking, an exemption statute. However, if petitioner can establish its entitlement to credit or refund under Tax Law § 1119, such credit would effectively offset any sales tax liability on petitioner's purchases of promotional envelopes. In effect, this constitutes an exemption. Moreover, the courts have treated Tax Law § 1119 as an exemption statute (see, Matter of Crown Publishers v. Tully, 96 AD2d 990, 466 NYS2d 822, revd on dissenting opn below 63 NY2d 660, 479 NYS2d 523). As an exemption statute, Tax Law § 1119 is to be strictly construed and ambiguities resolved against exemption (Allied New York Services v. Tully, 83 AD2d 727, 442 NYS2d 624).

§ 1101(b)(7). Just as clearly, however, Tax Law § 1119 contemplates receipt and storage of tangible personal property by the purchaser thereof. Accordingly, under the circumstances herein, petitioner's use of the promotional envelopes must go beyond mere receipt and storage for a "taxable use" to be found.

E. An examination of the record reveals that, in addition to receiving and storing the promotional envelopes, petitioner inserted promotional materials therein and placed the envelopes into U.S. Postal Service bags for mailing. Clearly, such use goes beyond receipt and storage. Moreover, such use falls well within the definition of that term as set forth in Tax Law § 1101(b)(7). Petitioner thus used the promotional envelopes to convey other promotional materials. That the envelopes were themselves promotional materials does not negate the fact that the envelopes were also used to convey other materials. Accordingly, unless petitioner can show that its use of the promotional envelopes fell within the limited nontaxable uses set forth in Tax Law § 1119(a)(2) or (4), the purchases of the envelopes were properly subject to tax and petitioner's assertion that such purchases were exempt must be denied.

F. Upon review of the record, it is concluded that petitioner has failed to show that its use of the promotional envelopes qualified for exemption under Tax Law § 1119(a)(4). Petitioner's use of the envelopes in inserting promotional materials therein and placing the envelopes in mail bags did not constitute "fabricating", "assembling" or "processing" as those terms were defined in the Division's regulations at 20 NYCRR 531.2(c), (d) and (e), respectively. The regulations do not define "incorporating" as that term is used in Tax Law § 1119(a)(4). It is appropriate, therefore, to interpret this word in its ordinary, everyday sense (Automatique v. Bouchard, 97 AD2d 183, 470 NYS2d 791). Webster's Ninth New Collegiate Dictionary defines "incorporate", in relevant part, as "to unite or work into something already existent so as to form an indistinguishable whole" and "to blend or combine thoroughly" (Webster's Ninth New Collegiate Dictionary 611 [1989]). The insertion of promotional materials into promotional envelopes as described herein does not constitute "incorporating" as defined above. Accordingly, petitioner has failed to establish entitlement to exemption under Tax Law

§ 1119(a)(4).

G. It is further noted that, having determined that petitioner's use of the promotional envelopes did not meet the requirements for exemption under Tax Law § 1119(a)(4), it follows that such use must also fail to meet the narrower exemption set forth in Tax Law § 1119(a)(2) which prohibits any use beyond receipt and storage.

H. Petitioner contended that, during the period at issue, the Division consistently interpreted Tax Law § 1119(a)(2) as providing an exemption for promotional materials where such materials were shipped or mailed outside New York State. Petitioner also contended that Tax Law § 1119(a)(4) provided a basis for a promotional materials exemption. Petitioner noted the Division's Technical Services Bureau memorandum, dated July 10, 1979, "Taxability of Promotional Materials Sent into New York State" (TSB-M-79[9]S), which provided, in relevant part, the following:

"The following is the policy of the State Tax Commission in regard to the taxable status of catalogs, promotional materials and other mailings sent by vendors, free of charge, directly to their customers.

* * *

"4. Mailed or shipped to customers outside New York State - EXEMPT

"This position is based upon the decision in the Matter of the Application of Ford Motor Company [State Tax Commn., October 21, 1983] and upon Bennett Brothers, Inc. v. State Tax Commission [62 AD2d 614, 405 NYS2d 803], where it was determined that the sender lacked real control over the catalogs once they were deposited with the common carrier.

"NOTE: 'Promotional materials and other mailings' consist of any tangible personal property which is given without charge by a manufacturer, wholesaler or distributor to a vendor for distribution to a prospective or current customer as an inducement or reward for a purchase and any literature or printed matter given without charge for distribution or use to advertise, induce, or facilitate a sale or to be used in any manner by said vendor. Examples of such items would include:

"1. Free gifts, whether a sample or given as the result of a purchase.

"2. Complimentary maps and other items given away to travel club members.

"3. Advertising literature.

"4. All sales and ordering forms, including applications, return envelopes, etc.

"5. Corporate annual reports.

"6. Travel brochures."

Petitioner contended that the envelopes were primarily promotional materials. Therefore, petitioner contended, such envelopes should be exempt pursuant to Tax Law § 1119(a) and the Division's policy as enunciated in the July 10, 1979 memorandum.

I. Petitioner's contention must be rejected. During the period at issue, Tax Law § 1119(a) did not provide for an exemption for promotional materials. This provision allowed an exemption from use tax where, after allowing for certain limited (nontaxable) uses, tangible personal property was shipped outside New York for use outside New York. Promotional materials are one kind of tangible personal property which may have been exempt under Tax Law § 1119(a) since such materials are generally not put to use as promotional materials until received by prospective customers. The fact that certain tangible personal property may be classified as promotional materials does not, however, qualify such property for exemption. The key to taxation or exemption is use or non-use in New York. Where tangible personal property is used in New York it is generally subject to use tax. The fact that this same tangible personal property may also be used outside New York does not result in an exemption. Accordingly, where, as here, promotional envelopes are used in New York to convey other promotional materials, the fact that these envelopes are also used as promotional materials outside New York does not render such materials exempt.

J. The result reached herein is consistent with Matter of Crown Publishers v. Tully (supra). In that case, gummed mailing labels which were affixed to catalogs were determined to not qualify for exemption under Tax Law § 1119(a)(4) and were therefore properly taxable. Unlike the instant matter, the labels at issue in Crown Publishers had no function other than their use in delivering catalogs. In contrast, the promotional envelopes herein had both a use in delivering promotional materials and were themselves promotional materials. Such a factual distinction does not, however, compel a different result. Since the in-state use of the envelopes did not fall within the uses enumerated in Tax Law § 1119(a)(4), then such use must be taxable,

notwithstanding the subsequent out-of-state use.

It should also be noted that Crown Publishers also supports a finding against petitioner under Tax Law § 1119(a)(2). The Appellate Division found that since Tax Law § 1119(a)(2) "only applies when the goods have not been put to any use" in New York, the mailing labels had been used in New York "when they were affixed to catalogues for mailing" (Crown Publishers v. Tully, supra, 466 NYS2d at 823). Here, the use of the promotional envelopes in conveying other promotional materials left section 1119(a)(2) unavailable to petitioner.

K. The foregoing analysis does not attempt to determine the "primary use" of the promotional envelopes. In the context of the sales tax production equipment exemption (Tax Law § 1115[a][12]), the Tax Appeals Tribunal has determined that, in order to qualify for the production equipment exemption, it is not necessary that the primary function of the equipment be in production (see, Matter of National Fuel Gas Distribution Corp., Tax Appeals Tribunal, March 14, 1991). In National Fuel, the Tribunal determined that, with respect to equipment having more than one purpose or function, the proper analysis is whether the equipment in question was predominantly used in production and that a determination of the equipment's "primary purpose" was "immaterial" (see also, Matter of B. R. DeWitt, Inc., Tax Appeals Tribunal, September 19, 1991). Similarly, in the instant matter, whether the primary purpose of the promotional envelopes was their "promotional" function or their "envelope" function, taxation depends upon whether this material was used in New York. Accordingly, primary purpose analysis is immaterial.

L. The foregoing interpretation of Tax Law § 1119(a)(2) and (4), as applied to the facts herein, is supported by the Division of Budget's memorandum in support of Laws of 1989 (ch 61), a law which, inter alia, amended the Tax Law to provide for an exemption from sales and use tax for "promotional materials" mailed or shipped from within New York to persons outside New York (Tax Law § 1115[n][1]). This provision further amended the Tax Law to define "promotional materials" to include "[a]ny advertising literature . . . and envelopes used exclusively to deliver the same" (Tax Law § 1101[b][12]). Under these provisions, which

became effective September 1, 1989, the promotional envelopes herein would be exempt from tax. In its memorandum in support of the bill, the Division of Budget, in discussing the then-current state of the law and the need for the above-referenced amendments, stated:

"New York printers suffer additional disadvantages arising from the fact that sales tax applies to the mailing envelopes and labels used in connection with promotional materials, as well as any personalized materials, regardless of where these materials are ultimately destined." (Memorandum of Division of Budget, Governor's Bill Jacket, L 1989, ch 61; emphasis supplied.)

The foregoing thus supports the conclusion reached above, to wit, that prior to the amendments contained in Laws of 1989 (ch 61), the Tax Law did not provide for an exemption from tax for promotional envelopes shipped out of New York.

M. The petitions of Garden Way Incorporated are denied and the notices of determination and demands for payment of sales and use taxes due, dated December 20, 1989 and April 8, 1991, as modified by the stipulation of facts herein, are sustained.

DATED: Troy, New York
May 20, 1993

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE